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TAGS: ECON PM COM EINV ENRG
SUBJECT: Deterioration of Panama's Business Climate Under President Martinelli

REF: 2008 PANAMA 405; 2009 PANAMA 657; 2009 PANAMA 757
2009 PANAMA 803

CLASSIFIED BY: Stephenson, Ambassador; REASON: 1.4(B), (D)

Summary

¶1. (C) The Government of Panama (GOP) disadvantaged at least two American companies in a \$55.5 million dollar improperly implemented emergency licitation procedures for electrical generators to fortify Panama's electrical generation capacity in anticipation of El Nino. This improper licitation in December 2009 adds to the body of evidence of a deterioration of the business climate in Panama under the Martinelli Administration.

Supply and Demand for Electricity

¶2. (U) Due to rapid economic growth over the past decade, Panama's peak demand for electricity grew by 3.9% per year. A regulatory regime that allows any qualified electric generation company to enter the market has kept Panama's peak demand for electricity from outstripping its supply. [ETESA, a state-owned company, owns and operates 100% of the transmission lines and EDEMET (operated by Spanish-owned Union Fenosa), EDECHI (operated by Union Fenosa), and Elektra Noreste (operated by British-owned Ashmore (aka AEI)) have concessions to distribute electricity in specific geographic areas.] While Panama's demand has not outstripped supply, there have been plenty of close calls and temporary public campaigns to cut electricity consumption. See reftel A.

Solution to El Nino's Effect

¶3. (U) The late December through April dry season is expected to be longer than normal in 2010 due to the El Nino weather phenomenon. If the dry season is extended, the reservoirs for several large hydro-electric generators may fall below levels to operate the generators. (53% of installed generation capacity is hydro and 60% of the produced electricity is hydro.) To mitigate the effect of El Nino, the government is encouraging companies with large backup generators to use them during peak hours, requesting consumers to cut back on energy usage, and purchasing 100MW of capacity from portable generators.

Questionable Licitation Procedures

¶ 4. (C) Due to the reported desire to quickly bring on 100MW of capacity, the Secretary of Energy Juan Urriola invoked emergency licitation procedures in December 2009 that allowed him to invite companies to bid over the course of 10 days. Three companies were invited to bid, but only Aggreko International submitted a bid. (Aggreko is listed on the FTSE and has corporate offices in London.) As a result, Aggreko International won the contract for \$55.5 million. The bidding process was closed after only six days instead of the required 10 days and two U.S. companies, Caterpillar and APR, separately told emboffs that they would have bid on the contract if offered the chance.

¶ 5. (C) When reporters questioned the licitation procedures and asked why Caterpillar was not invited to bid, Urriola publicly stated Caterpillar did "disastrous work." (Caterpillar's heavy equipment dominate the Panamanian market. Caterpillar also is building a Demonstration Center for its equipment in Panama and located a regional headquarters in Panama.) After the bad press Caterpillar received, APR decided not question the licitation due to their desire to win possible future contracts. Based upon quotes in a major newspaper - La Prensa, Urriola had a prior business relationship with Aggreko.

Comment

¶ 6. (C) The Investment Climate for American firms has deteriorated since the Martinelli Administration took office on July 1. Events that contributed to the deterioration are:

* The GOP procured approximately \$100 million through sole-source contracts between July 1 and September 25, 2009 under emergency licitation procedures; some of the contracts were for the expansion of the coastal highway (\$55 million), purchase of a Presidential airplane (\$21.9 million), and procurement of twenty ambulances (\$1.7 million).

* The GOP passed a law that eliminates contract concession changes by reverting contracts back to the original non-amended concession if the company harmed the people of Panama; thereby eliminating years of business predictability to contract holders. See reftel C. This law primarily targets port concessions, including Manzanillo International Terminal - one of the largest U.S. investors in Panama.

* The GOP now charges hydro-electric generators for use of water, which was not part of the original concession agreements. AES, an American firm, supplies almost one-third of Panama's electricity through hydro power and lost investment grade rating for \$300 million in bonds for a project in Panama. See reftel B.

* Royal Caribbean, a U.S. operated pipeline, and several other U.S. and foreign companies have expressed concern about the evolving business investment climate in Panama to emboffs.

* Even small U.S. investors experienced great angst when the Martinelli Administration proposed a law that changed the cost of titling rights of possession on coastal lands and islands from nominal administrative fees to an arbitrary GOP decided "fair market value." See reftel D. After extensive engagement by the Embassy and Panamanian civil society, there was an exemption inserted for rights of possession holders with less than five hectares. However, some American citizens have more than five

hectares; one American informed econoff that he intends to invoke the Bilateral Investment Treaty due to the possible indirect expropriation.

The Embassy will continue to actively advocate on behalf of U.S. companies and encourage the GOP to provide a predictable investment climate and to strengthen the rule of law.

STEPHENSON